

Statement of

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FEDERAL COMMUNICATIONS COMMISSION

Before the

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

of the

COMMITTEE ON ENERGY AND COMMERCE

UNITED STATES HOUSE OF REPRESENTATIVES

On

Problems with the E-Rate Program: Waste, Fraud, and Abuse Concerns in the Wiring of

Our Nation's Schools to the Internet

JUNE 17, 2004

Executive Summary

- The FCC Office of Inspector General has devoted considerable resources to oversight of the USF, and the E-rate program in particular.
- Several obstacles have impeded our ability to implement effective, independent oversight of the program. The primary obstacle we have dealt with has been a lack of adequate resources to conduct audits and provide audit support to investigations.
- We received allegations of wrongdoing by PRDOE related to the receipt of E-rate funding in 2001. We referred this matter to Federal law enforcement and are continuing to provide support the on-going investigation as warranted.
- The Puerto Rico matter and other audits and investigations we have been involved in highlight several concerns with this program. These include a lack of timely and effective resolution for audit findings from E-rate beneficiary audits, inadequacies in the competitive procurement requirements, effective use of purchased goods and services, inadequacies in applicant certifications regarding compliance with program requirements; weak recordkeeping requirements; differentiation between program rules and USAC operating procedures; issues related to technology planning, and issues relating to the discount calculation and payment.
- Until resources and funding are available to provide adequate oversight for the program, The Office of Inspector General is unable to provide assurance that the program is protected from fraud, waste and abuse.

Introduction

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear before the subcommittee today to discuss concerns regarding waste, fraud, and abuse in the E-rate program. In my comments and written testimony, I will provide a brief summary of my office's involvement in USF oversight, discuss our specific actions with respect to the Puerto Rico Department of Education's (PRDOE) involvement in the E-rate program, and describe in more general terms the concerns that my office has with the E-rate program. I would also like to introduce Thomas Bennett, the Assistant Inspector General for USF Oversight in the FCC Office of Inspector General. Mr. Bennett is responsible for USF oversight including oversight of the E-rate program and is available to answer specific questions you may have about my office's oversight of E-rate.

History of Independent Oversight of the Universal Service Fund (USF)

My office first looked at the USF in 1999 as part of our audit of the Commission's FY 1999 financial statement when the USF was determined to be part of the FCC's reporting entity for financial statement reporting. During that audit, we questioned the Commission regarding the nature of the USF and, specifically, whether it was subject to the statutory and regulatory requirements for federal funds. Starting with that inquiry, the Office of Inspector General has continued to devote considerable resources to oversight of the USF.

Due to materiality and our assessment of audit risk, we have focused much of our attention on the USF mechanism for funding telecommunications and information services for schools and libraries, also known as the “Schools and Libraries Program” or the “E-rate” program. Applications for program funding have increased from 30,675 in funding year 1998 to 43,050 for the current funding year. Applications were received from schools and libraries in each of the 50 states, the District of Columbia, and most territories and included 15,255 different service providers. Requested funding has increased from \$2,402,291,079 in funding year 1998 to \$4,538,275,093 for the current funding year.

OIG Oversight

During FY 2001, we worked with Commission representatives as well as with the Defense Contract Audit Agency (DCAA) and the Universal Service Administrative Company (USAC), to design an audit program that would provide the Commission with programmatic insight into compliance with rules and requirements on the part of E-rate program beneficiaries and service providers. Our program was designed around two corollary and complementary efforts. First, we would conduct reviews on a statistical sample of beneficiaries large enough to allow us to derive inferences regarding beneficiary compliance at the program level. Second, we would establish a process for vigorously investigating allegations of fraud, waste, and abuse in the program.

Unfortunately, several obstacles have impeded our ability to implement effective,

independent oversight of the program. The primary obstacle has been a lack of adequate resources to conduct audits and provide audit support to investigations. Since our initial involvement in independent oversight of the USF as part of our conduct of the FY 1999 financial statement audit, we have demonstrated our commitment to independent oversight of the USF by adding two (2) staff auditor positions and by organizing USF oversight activities under an Assistant Inspector General for USF Oversight. This represents dedication of three (3) of the eight (8) auditors on the staff of the FCC OIG to USF oversight. In addition to the OIG staff dedicated to USF oversight, two (2) audit staff members responsible for financial audit are also involved in USF oversight as part of the financial statement audit process.

We have also requested appropriated funding to obtain contract support for our USF oversight activities. In our FY 2004 budget submission, we requested \$2 million for USF oversight. That request was increased to \$3 million in the President's budget submission for FY 2004. Unfortunately, this funding was not included in the Commission's final budget for FY 2004. We are currently considering alternatives for obtaining access to contract audit support to implement the USF oversight portions of our FY 2004 audit plan.

Despite limited resources, my office has implemented an aggressive independent oversight program. My oversight program includes: (1) audits conducted using internal resources; (2) audits conducted by other federal Offices of Inspector General under reimbursable agreements; (3) review of audit work conducted by USAC; and (4) active

participation in federal investigations of E-rate fraud.

OIG Audits Using Internal Resources

We have completed eleven (11) audits that we initiated during fiscal year 2002 using auditors detailed from the Commission’s Common Carrier Bureau (since reorganized as the Wireline Competition Bureau) and audit reports are being finalized for the two (2) remaining audits. For the eleven (11) audits that have been completed, we concluded that applicants were compliant with program rules in five (5) of the audits, that applicants were generally compliant in two (2) of the audits, and that the applicants were not compliant with program rules in four (4) of the audits. We have recommended recovery of \$731,494 as shown below:

<u>Report Date</u>	<u>Applicant</u>	<u>Conclusion</u>	<u>Potential Fund Recovery</u>
09/11/02	Enoch Pratt Free Library	Compliant	\$0
02/03/03	Robeson County Public Schools	Compliant	0
02/05/03	Wake County Public Schools	Compliant	0
08/27/03	Albemarle Regional Library	Compliant	0
12/22/03	St. Matthews Lutheran School	Not Compliant	136,593
12/22/03	Prince William County Schools	Generally Compliant	5,452
12/22/03	Arlington Public School District	Generally Compliant	7,556
03/24/04	Immaculate Conception School	Not Compliant	68,846
04/06/04	Children’s Store Front School	Not Compliant	491,447
05/19/04	St. Augustine School	Not Compliant	21,600
05/25/04	Southern Westchester BOCES	Compliant	<u>0</u>
			<u>\$731,494</u>

Audits Conducted by Other Federal Offices of Inspector General

On January 29, 2003, we executed a Memorandum of Understanding (MOU) with the Department of the Interior (DOI) OIG. The MOU is a three-way agreement among the Commission, DOI OIG, and USAC for reviews of schools and libraries funded by the Bureau of Indian Affairs and other universal service support beneficiaries under the audit cognizance of DOI OIG. Under the agreement, auditors from the Department of the Interior perform audits for USAC and the FCC OIG. In addition to audits of schools and libraries, the agreement allows for the DOI OIG to consider requests for investigative support on a case-by-case basis. We have issued two (2) audit reports under this MOU and have completed fieldwork on three (3) additional audits. For the audit where we determined that the applicant was not compliant, we have recommended recovery of \$2,084,399. A summary of completed audits is as follows:

<u>Report Date</u>	<u>Applicant</u>	<u>Conclusion</u>	<u>Potential Fund Recovery</u>
11/06/03	Santa Fe Indian School	Compliant	\$0
01/07/04	Navajo Preparatory Academy	Not Compliant	2,084,399

We have also established a working relationship with the Office of Inspector General at the Education Department (Education OIG). In April 2003, Education OIG initiated an audit of the use of federal education funding to purchase equipment to make effective use of internal connections and internet connectivity funding by E-rate at a large recipient. My office has been providing support to this audit.

In January 2004, Education OIG presented a plan for an audit of telecommunication services at a large E-rate recipient. Because of the significant amount of E-rate funding for telecommunication services at this recipient, Education OIG has proposed that they be reimbursed for this audit under a three-way MOU similar to the existing MOU with DOI OIG. In April 2004, the Universal Service Board of Directors approved the MOU. We are in the process of finalizing the MOU for execution and initiating the audit.

Review of USAC Audits

We have reviewed work performed by USAC's Internal Audit Division and performed the procedures necessary under our audit standards to rely on that work. In December 2002, USAC established a contract with a public accounting firm to perform agreed-upon procedures at a sample of seventy-nine (79) beneficiaries from funding year 2000. The sample of beneficiaries was selected by the OIG. In a departure from the two previous large-scale E-rate beneficiary audits conducted by USAC, the agreed-upon procedures being performed under this contract would be performed in accordance with both the Attestation Standards established by the American Institute of Certified Public Accountants (AICPA) Standards and Generally Accepted Government Auditing Standards, issued by the Comptroller General (GAGAS). In March 2003, we signed a contract with a public accounting firm to provide audit support services for USF oversight to the OIG. The first task order that we established under this contract was for the performance of those procedures necessary to determine the degree to which we can rely on the results of that work (i.e., to verify that the work was performed in accordance with the AICPA and GAGAS standards). The OIG review team is currently completing

this work. Many of the audit findings raised by this body of work are reflected in the section addressing concerns with the E-rate program.

Support to Investigations

In addition to conducting audits, we are providing audit support to a number of investigations of E-rate recipients and service providers. To implement the investigative component of our plan, we established a working relationship with the Antitrust Division of the Department of Justice (DOJ). The Antitrust Division has established a task force to conduct USF investigations comprised of attorneys in each of the Antitrust Division's seven (7) field offices and the National Criminal Office. We are also supporting several investigations being conducted by Assistant United States Attorneys.

We are currently supporting twenty-two (22) investigations and monitoring an additional eighteen (18) investigations. Unfortunately, the increased interest in these cases has resulted in an increased demand for OIG audit support. In fact, the amount of audit support has exacerbated our previously stated concern about the availability of resources and our ability to implement other components of our USF oversight plan. Allegations being investigated in these cases include the following:

- Procurement irregularities – including lack of a competitive process and bid rigging;
- False Claims – Service Providers billing for goods and services not provided;
- Ineligible items being funded; and

- Beneficiaries are not paying the local portion of the costs resulting in inflated costs for goods and services to the program and potential kickback issues.

Puerto Rico Department of Education (PRDOE)

In this section of my testimony, I will briefly discuss allegations that my office received regarding wrongdoing related to PRDOE's involvement in the E-rate program, describe the preliminary investigation that we conducted of this matter, and discuss our on-going monitoring of PRDOE's involvement in the E-rate program as a result of these allegations. In addition, I will discuss programmatic concerns that my office has developed as a result of our involvement in audits and investigations that are highlighted by PRDOE's participation in the E-rate program.

Allegations from the Office of the Comptroller of Puerto Rico (OCPR)

In April 2001, my office was contacted by an auditor from the Office of the Comptroller of Puerto Rico (OCPR) and advised of allegations of wrongdoing by PRDOE related to the receipt of E-rate funding. We were advised that PRDOE did not comply with state and local procurement regulations during the vendor selection process for funding years 1998 and 1999 of the schools and libraries program. In addition, the auditor stated that two of the bidders argued against the selection decision and that the appellate process was not followed as required by the regulations governing PRDOE procurement actions. The auditor explained that the appellate process would have prevented PRDOE from signing a contract until an administrative review was conducted. Further, the auditor stated that

PRDOE may have violated program rules that require applicants to certify that they have secured access to all the resources necessary to make effective use of the goods and services being provided. The auditor explained that, as part of the audit process, representatives from OCPR visited schools and that “the majority of the schools” did not have electrical connections and secure areas for the equipment. Further, the auditor stated that the PRDOE has not obtained computers and had not provided training to teachers.

Preliminary Investigation

Based on the allegations, my office conducted a preliminary investigation to determine if the matter should be referred to federal law enforcement for investigation. After receiving the allegation from the Office of the Comptroller, we contacted the Universal Service Administrative Company (USAC) and requested documents relevant to this matter. On May 17, 2001, we received the requested documents from USAC. In their narrative summary, USAC stated that PRDOE has applied for universal service support for schools and libraries in each funding year of the program.

A summary of E-rate commitments and disbursements for funding years 1998, 1999, and 2000 is as follows:

Funding Year	Service Provider	Commitments	Disbursements
1998	Data Research Corporation (DRC)	\$11,796,599	\$11,796,160
	Puerto Rico Telephone Company, Inc. (PRTC)	<u>34,426,082</u>	<u>9,933,963</u>
		\$46,222,681	\$21,730,123
1999	Data Research Corporation (DRC)	\$42,124,085	\$25,204,157
	Puerto Rico Telephone Company, Inc. (PRTC)	<u>14,755,694</u>	<u>8,331,894</u>
		\$56,879,779	\$33,536,051
2000	Data Research Corporation (DRC)	\$37,674,521	\$32,565,581
	Puerto Rico Telephone Company, Inc. (PRTC)	<u>17,930,567</u>	<u>13,391,113</u>
		\$55,605,088	\$45,956,694
Total	Data Research Corporation (DRC)	\$91,595,205	\$69,565,897
	Puerto Rico Telephone Company, Inc. (PRTC)	<u>67,112,343</u>	<u>31,656,971</u>
		<u>\$158,707,548</u>	<u>\$101,222,868</u>

On May 29, 2001, we held a teleconference with the auditor from OCPR who had contacted my office regarding this matter. The objective of the teleconference was to further discuss the allegations set forth in the referral and to determine if any additional information was available relevant to this matter. During the teleconference, we discussed the scope of the audit performed by the Office of the Comptroller and the extent of testing performed during the review. In addition, we made arrangements to obtain additional information including a copy of the regulations governing the PRDOE procurement process. During the teleconference, the auditor stated that fieldwork on the audit was performed from March 2000 through April 2001. The auditor stated that a

draft report had been prepared summarizing the results of the audit but that the draft report was still going through the review process and would not be available for approximately two months. During the teleconference, the auditor provided a detailed description of the work performed to support the allegations contained in referral. With respect to the procurement, the auditor stated that they reviewed proposals and other documents documenting the evaluation process, interviewed PRDOE personnel involved in the process, and interviewed a service provider. To determine whether the PRDOE had the resources available to make effective use of the eligible services, OCPR auditors visited thirty (30) schools and examined the level of implementation.

Included in the documents provided by USAC was a Draft Agreed-Upon Procedures Report Prepared by Arthur Andersen summarizing the results of an agreed-upon procedures review they conducted for E-rate recipients in Funding Year 1998. Arthur Andersen selected the Puerto Rico Department of Education as one of the recipients where procedures were performed. Arthur Andersen examined the procurement process during Funding Year 1998 as part of that review. In addition, Arthur Andersen visited two schools and a data center as part of the examination to determine whether the PRDOE had the resources available to make effective use of the eligible services. In their draft report, Arthur Andersen stated that they had ascertained “through discussion with PRDOE management that they had established appropriate (sic) to evaluate and select the most cost-effective bidder based on the responses to their 470 posting.” Arthur Andersen further stated that “PRDOE management also indicated that all bids received were appropriately evaluated in accordance with state and local requirements.” With

respect to the availability of resources, Arthur Andersen stated that “we noted that there were no (desktop) computers in any of the classrooms visited” and that, as a result, “PRDOE was not able (as of the date of our site visit) to fully meet the educational objectives (and training requirements) for which E-Rate funding had been provided.” We obtained additional information from USAC regarding the scope of the Arthur Andersen review including working papers documenting the procedures performed to evaluate the procurement process followed by PRDOE.

Based upon our assessment of this information and our discussion with the auditor from the OCPR, we determined that the audit performed by OCPR was more comprehensive in nature and included a more detailed examination of both the procurement process and the availability of resources. Further, we determined that OCPR, given their role in the government of Puerto Rico and their knowledge of the operations of PRDOE, was better positioned to evaluate the schools and libraries program in Puerto Rico. Based on the results of our preliminary investigation, we referred this matter to Federal law enforcement on May 31, 2001. That investigation is on-going and we are continuing to provide support to the investigation as warranted.

On-going Monitoring of PRDOE

In addition to supporting an on-going Federal investigation related to this matter, my office has continued to monitor efforts by PRDOE to address issues related to funding years 1998, 1999, and 2000, and to continue to participate in the E-rate program. An auditor from my staff participated as an observer in three (3) meetings between USAC

and PRDOE during 2002. In a meeting in January 2001, representatives from PRDOE presented a plan to address concerns from funding years 1998, 1999, and 2000. In a meeting in April 2002, representatives from PRDOE provided a status report on activities that they had taken to implement their corrective action plan. In a meeting in October 2002, representatives from PRDOE, including the Secretary of PRDOE, provided a status on implementation of corrective action and made an argument for approval of FY 2001 and 2002 funding. In February 2004, a representative from my office traveled to Puerto Rico to assist professional staff from the Energy and Commerce Committee during their investigation of PRDOE participation in the E-rate program.

Programmatic Concerns Highlighted by PRDOE's Participation in E-rate

The Puerto Rico matter highlights several concerns that my office has with the E-rate program as a result of our involvement in audits and investigations.

Resolution of Audit Findings and Fund Recoveries - Since our involvement in this program, I have become increasingly concerned about efforts to resolve audit findings and to recover funds resulting from E-rate beneficiary audits. It has been our observation that audit findings are not being resolved in a timely manner and that, as a result, actions to recover inappropriately disbursed funds are not being taken in a timely manner. In some cases, it appears that audit findings are not being resolved because USAC is not taking action in a timely manner. In other cases, findings are not being resolved because USAC is not receiving guidance from the Commission that is necessary to resolve

findings. USAC is prohibited under program rules from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. As a result of this prohibition, USAC must seek guidance from the Commission when audit findings are not clearly violations of Commission rules.

In the case of PRDOE, we have concerns about the manner in which audit findings identified by Arthur Anderson during their audit of PRDOE’s participation in the E-rate program in funding year 1998 were resolved. Although we were not involved in this audit, we obtained and reviewed the report as part of our preliminary investigation of the allegations raised by OCPD. In addition, we have continued to obtain information on the resolution of USAC audits as part of our program oversight activities. In their report, Arthur Anderson identified three (3) findings during their audit of PRDOE. Two of the audit findings related to services being delivered after the last date to receive services. The third finding related to inadequate detail being provided on customer bills. The three findings and resolution of those findings as identified in the final audit report are as follows:

<u>Finding</u>	<u>Finding Detail</u>	<u>Resolution</u>
Services delivered after the last date to receive services	6 of 38 cabling projects could not be verified as complete as testing was not completed.	No Action Required. Received FCC waiver of rule violation consistent with the other 1998 (FY1) rule violations waived in the 10/8/99 order.

<p>Inadequate detail provided on customer bills</p>	<p>The contract payment was reduced due to the contractor failing to install in some schools by the due date. However, there was insufficient documentation to verify the accuracy of the reduction.</p>	<p>No Action Required. This observation has been classified as a non-material finding, as there is not evidence of any request for reimbursement for ineligible equipment.</p>
<p>Services delivered after the last date to receive services</p>	<p>Non e-rate equipment (100,000 workstations) was not installed due to a legal dispute with a potential bidder.</p>	<p>Action Pending. SLD wrote to the Puerto Rico Department of Education (PRDOE) about this observation. PRDOE then asked for a meeting with the FCC and SLD at which time they disclosed that there were significant irregularities concerning the application and installation of approved services. PRDOE has been responsive to the issues raised and has conducted their own investigation. Commitments and disbursements are on hold pending final resolution with the FCC.</p>

With respect to the first finding, USAC determined that no action was required because of a Commission rule waiver for funding year 1998. We examined the finding and the rule waiver and questioned the applicability of the waiver to this finding. The finding relates to the delivery of goods and services by the required delivery date. The section of the rule waiver referenced by USAC in response to our inquiries addresses competitive bidding and form 471 filing. USAC explained that they received confirmation from Commission staff that an installation after the September 30 deadline would qualify

under the order. We obtained and examined a copy of this confirmation and questioned the authority of the staff attorney who provided this confirmation to waive rules that are “similar” to the rules waived in the rule waiver for funding year 1998. We requested an explanation from the Commission staff and were advised that the interpretation by the staff attorney in this matter was “overly broad” and that waiver order “did not waive the requirement that services be installed by a specific date.”

With respect to the second finding, USAC determined that no action was required and classified this as a non-material finding at the same time stating in the report that the “Audit report did not contain sufficient detail to determine the exposure amount.” We requested additional explanation from USAC and were advised that “because of a lack of detail within the contract and customer bills the auditors were unable to verify the accuracy of this reduction” and that “the auditor did not make a determination as to the potential risk.” USAC went on to state that “(t)he lack of detail in the contract or the customer bill is not considered a rule violation and we have not sought recovery in these instances.” The issue of violating program rules versus non-compliance with USAC procedures is a matter of serious concern that is addressed later in this testimony. The issue of required documentation under program rules is also an area of concern that I address in more detail later in this testimony.

The third finding, computers not being installed as a result of a bidder dispute, is the issue that started the discussion between USAC and PRDOE in which other irregularities were raised. In response to a letter from USAC regarding this finding, PRDOE met with

USAC in January 2002 and presented the results of an assessment they performed on the status of the school network funded by E-rate. We refer to this assessment in our discussion of concerns related to applicant certifications and delivery of goods and services.

Competitive Procurement - Program rules require that applicants use a competitive procurement process to select vendors. In establishing this requirement, the Commission recognized that “(c)ompetitive bidding is the most efficient means for ensuring that eligible schools and libraries are informed about all of the choices available to them” and that “(a)bsent competitive bidding, prices charged to schools and libraries may be needlessly high, with the result that fewer eligible schools and libraries would be able to participate in the program or the demand on universal service support mechanisms would be needlessly great.”

Applicants are required to submit a form 470 identifying the products and services needed to implement the technology plan. The form 470 is posted to the USAC web page to notify service providers that the applicant is seeking the products and services identified. Applicants must wait at least 28 days after the form 470 is posted to the web site and consider all bids they receive before selecting the service provider to provide the services desired. In addition, applicants must comply with all applicable state and local procurement rules and regulations and competitive bidding requirements. The form 470 cannot be completed by a service provider who will participate in the competitive process as a bidder and the applicant is responsible for ensuring an open, fair competitive process and selecting the most cost-effective provider of the desired services. Further, although

no program rule establishes this requirement, applicants are encouraged by USAC to save all competing bids for services to be able to demonstrate that the bid chosen is the most cost-effective, with price being the primary consideration.

Although the programs competitive bidding requirements were intended to ensure that schools and libraries are informed about all of the choices available to them, we have observed numerous instances in which beneficiaries are not following the program's competitive bidding requirements or are not able to demonstrate that competitive bidding requirements are being followed. In the case of PRDOE, we have several concerns about whether or not a competitive procurement process was followed during the selection of service providers.

- OCPR highlighted numerous concerns regarding the competitive process in their allegations provided in April 2001 and previously discussed in this testimony.
- OCPR reported numerous examples of PRDOE non-compliance with procurement regulations in Audit Report TI-03-09 summarizing the results of their audit of the acquisition of equipment and services related to the EDUNET network (i.e., PRDOE's involvement in the E-rate program).
- The United States Department of Education Office of Inspector General (ED OIG) has issued numerous reports over the last several years highlighting contract administration issues with PRDOE.

Program rules require that applicants follow a competitive process and that applicants

keep the kinds of procurement records that they keep for other purchases. However, Commission staff have provided guidance stating that “the mere failure of the beneficiary to produce documentation relating to the competitive bidding process cannot form the basis for finding a rule violation or seeking recovery of funds. A rule violation could be established if the audit process secured the beneficiary’s record retention plan and determined that the beneficiary had failed to comply with that policy.” Commission staff have stated that a rule violation “could be established if the audit process secured the beneficiary’s record retention plan and determined that the beneficiary had failed to comply with that policy.” In effect, Commission staff have taken the position that if no record retention plan exists, there is no requirement for the applicant to maintain records.

Delivery of Goods and Services - Site visits are conducted during most E-rate beneficiary audits. Site visits are conducted for several reasons including to evaluate the eligibility of facilities where equipment is installed, verify that equipment is installed and operational, and to verify that equipment is being used for its intended purpose. In the case of PRDOE, we have several concerns about the delivery of goods and services.

- In their January 2002 presentation to USAC, PRDE reported that:
 - the status of each school regarding internal cabling, communication lines, servers, physical facilities and electricity was unknown because no reliable documentation was available;

- communication lines from a sample of 100 schools were not installed, were not activated, or were out of service; and that
- many of the schools have electrical deficiencies and security problems.

- During their audit, Arthur Anderson reported that six (6) of thirty (38) cabling projects could not be verified as complete as testing was not completed. As I indicated previously, USAC closed this audit finding because of guidance received from Commission staff regarding the Commission's rule waiver regarding funding year 1998. Commission staff have subsequently advised us that the rule waiver order for funding year 1998 did not address the rule governing delivery of equipment by the required due date.

- In February 2004, a representative from my office accompanied professional staff from the Energy and Commerce Committee during a visit to Puerto Rico. During that visit, the OIG representative and House staff were advised that a large number of wireless cards (approximately 74,000) that were purchased with E-rate funding remained on a loading dock in a PRDE warehouse. We visited the warehouse and confirmed that the wireless cards were in their original packaging on pallets. The E-rate program purchased 74,224 wireless cards during funding year 1999 at a total cost to the program of approximately \$24,123,592, including installation.

Reliance on Applicant Certifications – The E-rate program is heavily reliant on applicant certifications. On the form 470, applicants certify that the support received is conditional

upon the ability of an applicant to secure access to all of the resources, including computers, training, software, maintenance, and electrical connections, necessary to use effectively the services that will be purchased under this mechanism. Other certifications are required on various program forms. In the case of PRDOE, we have several concerns about whether or not PRDOE was prepared to make effective use of the goods and services purchased.

- In their January 2002 presentation to USAC, PRDOE reported that:
 - The server and communications infrastructure required at the central offices was inappropriate to properly utilize the network;
 - no network management process had been defined; and
 - many of the schools had electrical and security problems.

- In their April 2003 Audit Report (TI-03-09) summarizing the results of their audit of the acquisition of equipment and services related to the EDUNET network, OCPR reported that:
 - The communications network infrastructure installed in the school was not being used;
 - the Department had not acquired computers for the students;
 - the teachers had limited knowledge of computer use; and

- the physical and electrical conditions in the schools did not have the capacity required to use the communications equipment and computers. With respect to this issue, OCPR reported that:
 - Fifteen of the thirty schools visited did not have adequate electrical installations for connecting the computers they expected to acquire for students;
 - twelve of the thirty schools visited did not have grills for the protection of the installed communications equipment;
 - eleven of the thirty schools did not have locked cabinets for the equipment; and
 - four of the thirty schools did not have adequate locks on the doors of the rooms where the communications equipment was located.

Other Programmatic Concerns

In addition to concerns that are highlighted by the PRDOE's participation in the E-rate program, my office has identified other concerns as a result of our participation in E-rate audits and investigations. A brief summary of those concerns is as follows:

Program Design and Beneficiary Compliance - Under Commission staff oversight, USAC has implemented numerous policies and procedures to administer the E-rate program. In some cases, the Commission has adopted these USAC operating

procedures, in other cases however, USAC procedures have not been formally adopted by the FCC. In those cases where USAC implementing procedures have not been formally adopted by the Commission, it is the position of Commission staff that there is no legal basis for recovery of funds when applicants fail to comply with these procedures.

We are concerned about the distinction that Commission staff makes between program rules and USAC implementing procedures for a number of reasons.

- First, we believe that this distinction represents a weakness in program design. Within their authority under program rules, USAC has established implementing procedures to ensure that program beneficiaries comply with program rules and that the objectives of the program are met. In those cases where USAC has established implementing procedures that are not supported by program rules, USAC and the Commission have no mechanism for enforcing beneficiary compliance.
- Second, we believe that it is critical that participants in the E-rate program have a clear understanding of the rules governing the program and the consequences that exist if they fail to comply with those rules. We are concerned that the Commission has not determined the consequences of beneficiary non-compliance in many cases and that, in those instances where the Commission has addressed the issue of consequences for non-compliance, the consequences associated with clear violations of program rules do not appear to be consistent.

- Third, a clear understanding of the distinction between program rules and USAC implementing procedures is necessary for the design and implementation of effective oversight. It is necessary for the timely completion of audits and the timely resolution of audit findings and implementation of corrective action resulting from audits.

Applicant Technology Planning – As I have discussed above, program rules require that applicants prepare a technology plan and that the technology plan be approved. The approved technology plan is supposed to include a sufficient level of information to justify and validate the purpose of a request for E-rate funding. USAC implementing procedures state that approved technology plans must establish the connections between the information technology and the professional development strategies, curriculum initiatives, and library objectives that will lead to improved education and library services. Although the technology plan is intended to serve as the basis for an application, we have observed many instances of non-compliance with program rules and USAC procedures related to the technology planning process. Examples of technology planning concerns identified during audits and investigations are as follows:

- Technology plans are not being reviewed and approved in accordance with program rules. Commission staff have provided guidance failure to prepare a technology plan and have that plan approved in a timely manner is basis for full recovery of disbursements.

- Technology plans do not address all required plan elements in accordance with USAC implementing procedures for technology planning. As I have discussed above, Commission staff have provided guidance that failure to comply with USAC implementing procedures for technology plans is not a rule violation and does not warrant recovery of funds.
- Applicants not being able to provide documentation to support the review and approval of technology plan.

USAC guidance on technology planning states that “(i)n the event of an audit, you may be required to produce a certification similar to the SLD sample "Technology Plan Certification Form," in order to document approval of your technology plan.” Numerous audits have included findings beneficiaries were unable to provide documentation to demonstrate the review and approval of technology plans. Although program rules require that applicants have a technology plan and that the plan be approved, the rules do not require that the applicant maintain specific documentation regarding the approval process.

Discount Calculation - The E-rate program allows eligible schools and libraries to receive telecommunications services, Internet access, and internal connections at discounted rates. Discounts range from 20% to 90% of the costs of eligible services, depending on the level of poverty and the urban/rural status of the population served, and are based on the percentage of students eligible for free and reduced lunches under the

National School Lunch Program (NSLP) and other approved alternative methods. A number of audits have identified audit findings that applicants have not followed program requirements for discount rate calculation or were unable to support the discount rate calculated.

Payment of the Non-Discount Portion - Applicants are required to pay the non-discount portion of the cost of the goods and services to their service providers and service providers are required to bill applicants for the non-discount portion. The discount rate calculation and program requirement for payment of the non-discount portion are intended to ensure that recipients avoid unnecessary and wasteful expenditures and encourage schools to seek the best pre-discount rate. Examples of concerns identified during audits and investigations are as follows:

- Applicant not paying the non-discount portion;
- Applicant not paying the non-discount portion in a timely manner; and
- Service providers not billing recipients for the non-discount portion.

Conclusion

The Office of Inspector General remains committed to meeting our responsibility for providing effective independent oversight of the Universal Service Fund program. As I have described in this testimony, we continue to have numerous concerns about this program. The results of audits that have been performed and the allegations under

investigation lead us to believe the program may be subject to unacceptably high risk of fraud, waste and abuse through noncompliance and program weaknesses. We are concerned with efforts to resolve audit findings and to recover funds resulting from E-rate beneficiary audits and we are concerned with aspects of program design and beneficiary compliance with program rules. In view of these concerns, I believe that it would be appropriate to conduct a broad based review of the program.

We believe we have made significant progress toward our goal of designing and implementing an effective, independent oversight program. However, primarily because of a lack of adequate resources, we have been unable to implement our oversight program. As I have stated previously, until resources and funding are available to provide adequate independent oversight for the USF program, we are unable to give the Chairman, Congress and the public an appropriate level of assurance that the program is protected from fraud, waste and abuse.

Thank you, Mr. Bennett and I will be happy to answer any of your questions.